

IMPACT OF NATURAL GAS PRICES ON STATE GOVERNMENT

A Report Prepared for the

Legislative Finance Committee

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INTRODUCTION AND PURPOSE

At the December meeting of the Legislative Finance Committee (LFC), staff presented a short paper on natural gas usage in state government and potential vulnerability to record high prices. At that time, the LFC asked for an update at the March meeting.

The purpose of this report is to provide an update on state expenditures for natural gas and the potential for programmatic impact of high natural gas prices.

SUMMARY OF PREVIOUS INFORMATION

State government expenditures for natural gas are dominated by the Montana University System (MUS), which accounted for over 2/3 of all expenditures in FY 2004 and almost 60 percent of all expenditures in FY 2005. For the remainder of state government, those agencies with a number of buildings outside of the capitol complex in Helena generally pay for all natural gas expenditures from their HB 2 appropriation and bear the risk of any price changes. Buildings within the capitol complex in Helena pay for natural gas through rental charges by the Department of Administration. These charges are capped at the level approved by the 2005 Legislature, making the Department of Administration at risk to cost changes.

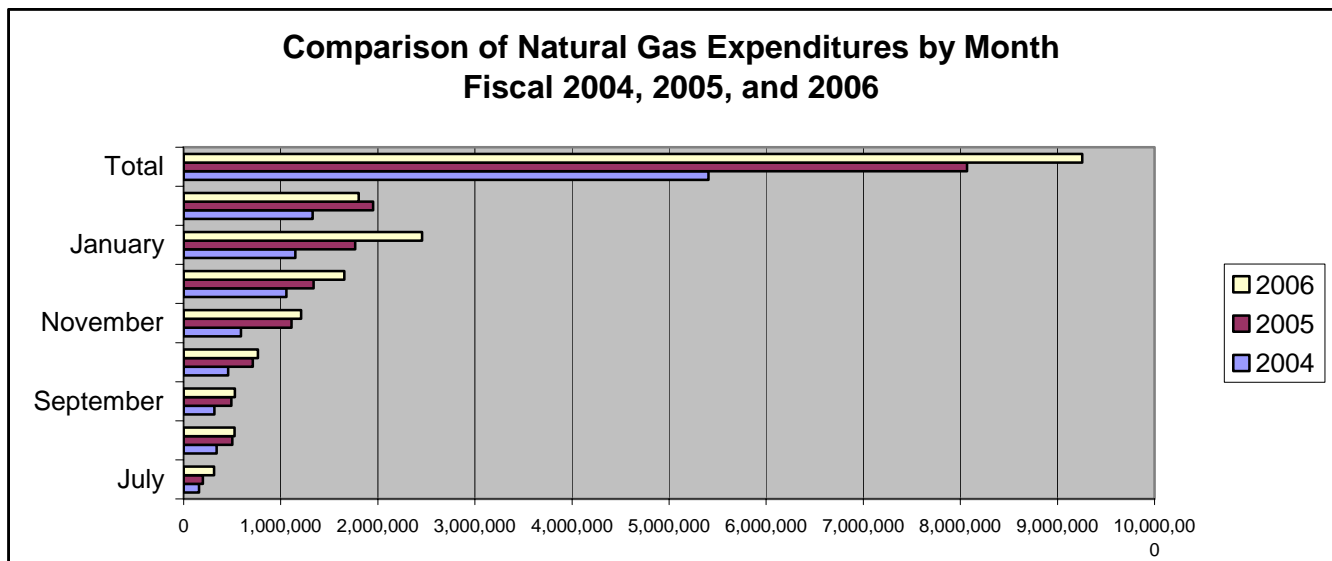
Buildings on and Off the State Contract 2007 Biennium	
On Contract	Off Contract - Sample, only
<u>Within Helena</u>	
Capitol and Capitol Annex	Military Affairs
Old Livestock (General Services Division)	OPI
Mitchell (Administration and Revenue)	Corrections
Historical Society	Commerce
Cogswell (DPHHS)	Main DNRC Building
Transportation	MSU - Billings
FWP (main building)	Pine Hills School
DPHHS	State Fund Building
Metcalf (DEQ)	Law Enforcement Academy
New Justice/State Library	Other MDT buildings
Scott Hart (Agriculture and Livestock)	
Walt Sullivan (Labor and Industry)	
<u>Out of Helena</u>	
Montana State Hospital - Warm Springs	
Montana State Prison - Deer Lodge	
Montana Developmental Center - Boulder	
Montana Veterans Home - Columbia Falls	
Montana Mental Health Nursing - Lewistown	
Montana University System	
MSU	
MSU - Northern	
MSU - Bob Miller Pavilion	
MSU - Marsh Lab	
MSU Firm Gas Meter	
MSU Family Student Housing	
UM	
UM - Montana Tech	
UM - Western	
UM Scisson Craghead Apartments	

With the exception of the MUS, most state buildings are “on the meter”, meaning that they are subject to changes in natural gas prices as dictated by the market and consequently at risk from both higher prices and volatility of prices. Most of the MUS and the remaining state owned buildings are part of a contract with Jefferson Energy (Jetco), from which the state purchases the natural gas commodity. Consequently, many of the biggest users of natural gas (including the largest school districts) are protected both from volatility and from high prices (although the reverse is obviously true if prices fall).

The contract with Jetco runs through June 30, 2007 and totals \$6.86/dkthm for buildings without natural gas storage and \$6.66/dkth for agencies with natural gas storage.

UPDATE

The following chart shows expenditures of state government for natural gas through January. (An update of expenditures through February will be made prior to the March meeting and this report will be updated at that time.)



As shown in the table, expenditures are still trending significantly higher than the base year, which the legislature inflated 18 percent for FY 2006 and 12 percent for FY 2007. The following extrapolates expenditures so far in FY 2006 based upon the average expenditures for the previous two years, and compares it to the amount in the state's budgeting system at the end of the last legislative session for several high usage agencies. Please note that the legislature does not budget at this level, and agencies can utilize other operating expense appropriations to pay for natural gas (or other expenses) and move appropriations such as personal services to operating expenses with proper documentation and approval. However, the chart does show the degree to which some agencies may have to prioritize other expenditures to pay natural gas costs.

Please note two things:

- 1) For a majority of the costs represented in the chart, an extrapolation will be valid for price changes because of the consistency of the contract amount, but will be less so for those agencies "on the meter" due to price volatility. No weather related factors in total cost changes are accounted for.
- 2) The Montana University System is funded through a formula amount that does not specify the amount in MBARS for natural gas at the units. The information in the table is based upon utilities budgets paid for with current unrestricted funds for the 2007 biennium and the percent of that budget that is natural gas, both as reported by the system. Because the table only includes current unrestricted funds, it consequently does not include such facilities as student housing. Various campuses of the university system have instituted student surcharges to cover some of the anticipated shortfalls in funding, which are not included in the table.

Extrapolated Expenditures Compared to Appropriation Selected Agencies Using Expenditures through January			
Agency	FY 2006 Appropriation	Extrapolated Expenditures	Difference
Administration*	\$674,165	\$671,629	\$2,536
DPHHS	603,217	694,754	(91,537)
Military Affairs***	558,053	976,237	(418,184)
Corrections	616,706	808,787	(192,081)
Transportation	544,060	601,914	(57,854)
FWP	147,077	257,861	(110,784)
UM**	1,896,708	1,848,407	48,301
MSU**	2,628,367	2,774,925	(146,558)
*Rent charged to agencies assumed an 18 percent increase in natural gas prices			
**From the Board of Regents operating plans, October 2005			
***Department currently estimating a difference of \$1.0 million			

As shown, the Department of Corrections continues to show a significantly higher rate of expenditure than could be sustained by the level of natural gas consumption assumed in the appropriation. If current expenditure patterns continue, that department would have to reallocate expenditures from other areas to stay within appropriations, exacerbating the current shortages caused by population increases. The Department of Military Affairs also continues to show a significantly higher rate of expenditure. While the department has in the past received federal funds through the budget amendment process and used a portion to pay for utility costs, as of this writing the department had not received any additional funds in FY 2006.

Unlike as indicated in the December report, the Department of Public Health and Human Services (DPHHS) is now trending higher than the appropriation. While the percentage of total expenditures the overage represents in DPHHS is very small, it could represent a prioritization issue for two reasons:

- 1) Natural gas costs are incurred at DPHHS facilities outside of the capitol complex, primarily outlying institutions (such as the Montana Development Center) and agency offices around the state, which may have more limited reprioritization options.
- 2) According the several of the latest budget status reports, the department is currently in a deficit situation, meaning that options for transferring general fund from other areas of the budget to address natural gas costs are limited.

At the same time, prices on the natural gas spot market continue to fall, meaning the future costs of natural gas do not portend as potentially a dire situation for the future. As stated in the previous report, how this falling price is translating into costs actually paid by state government is unclear at this time, due in part to the long-term nature of many natural gas purchase contracts and the potential need for additional purchase on the spot market, and the lag in manifestation in the price of the commodity itself. The following shows the daily average spot price on the Calgary exchange. It is from Alberta that most gas consumed in Montana comes.

Next Day Price Index Value Calgary Exchange	
Time	Price
Last Trading Date*	\$5.3051
<u>Weighted Averages</u>	
January	7.7726
December	11.7322
November	8.0549
October	11.7990
September	10.5432
August	8.7143
July	7.0814
June	6.9448
In Canadian currency	
*March 1	

Please note that this chart is in Canadian currency. Based upon the rate of exchange as of March 2, 2006, the January weighted average in \$USD was \$4.69.

Staff will continue to monitor this issue.

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